

CAPITAL PLANNING ADVISORY BOARD

Minutes of the 5th Meeting of the 2003 Calendar Year

October 9, 2003

The 5th meeting of the Capital Planning Advisory Board was held on Thursday, October 9, 2003, at 9:00 AM, in Room 327 of the Capitol. Representative Perry Clark, Co-Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Senator Albert Robinson, Co-Chair; Representative Perry Clark, Co-Chair; Senator Paul Herron Jr.; Representative Ron Crimm; James Deckard; Bill Hintze; Sherron Jackson; Lou Karibo; Glenn Mitchell; Garlan Vanhook; and Judge William Wehr.

Guests: Paul Blanchard, Eastern Kentucky University; Donna Masters, Justice Cabinet; Tom Schulz, KSDCC; Ed West, Western Kentucky University; Darrell Link; Grant County Judge Executive; Paul Johnson, Revenue Cabinet; Doug Robinson, Governor's Office for Technology; and Charlie Harman, Workforce Development Cabinet.

LRC Staff: Pat Ingram, Staff Administrator; Mary Lynn Collins; Nancy Osborne; and Dawn Groves.

Senator Herron's motion to approve the September 26, 2003 minutes was seconded by Mr. Mitchell and passed without objection.

At Representative Clark's request, Ms. Ingram reviewed the two Information Items in the members' folders. The first contained a newspaper article and editorial from *The (Frankfort) State Journal* about the long-range plan for renovating state office buildings in Frankfort. The second item transmitted a letter from Cicely Jaracz Lambert, Director of the Administrative Office of the Courts, addressing questions raised during the Board's review of the Judicial Branch capital plan on September 26.

Representative Clark said changes to the 2004-2010 agency capital plans were due on October 1, and asked Ms. Ingram to review the changes that had been submitted. Ms. Ingram explained there had been changes to several of the plans, and the major changes were summarized in a report included in the members' folders. She reviewed some of the items listed including changes for the Department of Education, the Department of

Military Affairs, the Workforce Development Cabinet, the University of Kentucky, and Western Kentucky University.

Representative Clark next introduced Deputy State Budget Director Bill Hintze to present an update on the state's budget and revenue situation. Mr. Hintze reviewed a handout, which he had distributed to members.

Mr. Hintze explained that the state budget totals approximately \$14 billion annually from all fund sources, including about \$7 billion from the General Fund. Looking back over the past three years, he reviewed the budget shortfalls and actions taken to address those shortfalls in FY 2000/01 (\$185.4 million), FY 2001/02 (\$687.1 million), and FY 2002/03 (\$89.9 million). He noted that the revenue shortfalls were in the General Fund, but all fund sources have been used to address the problem. He said if not for the federal fiscal relief, Kentucky would have started FY 2003/04 \$45 million short.

Mr. Hintze explained that House Bill 269, the enacted budget for 2002-04, is structurally imbalanced – expenditures are greater than the amount of funds the state is taking in on a recurring basis. The amount of that imbalance from FY 2003/04 looking forward to FY 2004/05 is calculated at \$400 million.

Mr. Hintze said the Budget Reserve Trust Fund (BRTF) had been reduced from a record high of \$278 million at the beginning of 2000-02 to a balance of \$0 at the end of 2000-02. He said the 2002-04 budget included appropriations of \$30 million for the BRTF and that a FY 2003/04 surplus plan appropriation of \$23.8 would allow for a FY 2003/04 balance of \$54.8 million in the BRTF. However the BRTF is the source for payment of Necessary Government Expenses; those costs are estimated to be \$15 million.

Mr. Hintze said a \$274.4 million revenue shortfall is now projected for FY 2003/04; that figure is subject to revision by the Consensus Forecasting Group (CFG) before October 15. He then reviewed the specific tax components that comprised the CFG's FY 2003/04 General Fund revenue estimates for January/April (on which the 2002-04 budget was based) and their August estimates which were \$274.4 million lower. He noted that first quarter revenues (July-September), cumulatively, are down by 0.7 percent. However, the budget was predicated on growth of 4.6 percent.

Looking ahead to a preliminary view for 2004-06, Mr. Hintze said the CFG's current General Fund planning estimate is for 0.5 percent growth in FY 2003/04 (\$33.1 million), 3.5 percent growth in FY 2004/05 (\$235.5 million), and 4.9 percent growth in FY 2005/06 (\$343.1 million). He said the challenge or problem is to match the new dollars that are anticipated with the structural imbalance (approximately \$400 million), a recurring amount of revenue shortfall, and the yet to be determined increased costs of maintaining current programs.

Mr. Hintze then presented a structural budget analysis described as neither a best case nor a worst case scenario. He explained that the structural budget imbalance was due to the use of non-recurring resources including fund transfers, and due to recurring expenditures that were not funded in the 2002-04 budget (e.g., debt service to fully fund bonds, education textbooks and school rewards payments, Medicaid expenditures funded with one-time restricted funds, and deferred expenditures for maintenance and operation of new facilities). A commitment for payments from the General Fund to shore up the Workers Compensation program, which has continually been deferred since revenue shortfalls began in 2001, is not reflected on the current listing but will be in the future.

Mr. Hintze noted that the structural budget analysis did not take into account the actual FY 2002/03 revenue shortfall or the expected FY 2003/04 revenue reduction, nor did it include any allowance for growth in populations served, increased pay or benefit costs for public employees, normal inflationary growth, the Medicaid shortfall, rate/contract/provider adjustments, program expansion, new programs, new construction/renovation/repair, or new debt service.

Senator Robinson asked if the \$15 million figure being used as the estimate for Necessary Government Expenses was adequate. Mr. Hintze said it appears to be adequate. However, the actual cost depends on circumstances which may require calling out the National Guard or matching federal disaster funds (e.g., weather such as floods, tornadoes, etc), the severity of the fire season, and areas of the budget which require payment from this category under specified circumstances (e.g., housing prisoners in jails). Senator Robinson noted that Medicaid costs could require about \$100 million more, and a ruling against the state in the case regarding funding for education would also substantially increase the needs already presented.

In response to further questions from Senator Robinson about issuing bonds to address the state's needs, Mr. Hintze, said the ability to sell additional bonds will depend not only on interest rates and bond ratings, but will also be dependent on addressing the structural imbalance in the budget. He noted that the biennial budget always includes a certain amount of bonded indebtedness – ranging from \$200 million to \$250 million in the worst of times, to \$1.1 billion in the best of times. Historically, the first biennium of a new governor is on the low side.

Representative Clark asked about the growth in the individual income tax for the first quarter of the fiscal year. Mr. Hintze said, while there was growth, it was not as much as initially forecast when the budget was developed. However, he said the real problem is that other taxes (e.g., sales, corporate, inheritance, etc.) are also lagging behind the forecasts. Representative Clark said he is concerned that the situation may be worse than is indicated by current projections.

Senator Robinson and Representative Clark thanked Mr. Hintze for his presentation. Representative Clark then said while the Board reviewed most of the policy recommendations for the 2004-2010 statewide capital improvements plan at the last meeting, it had asked that one recommendation be revised and that one additional recommendation be drafted. He asked staff to present those items.

Ms. Ingram said the first item was the Board's requested revision of the recommendation concerning allocations from the Office for the New Economy (ONE). She noted that at the last meeting there were some questions and concerns about what should be recommended regarding the timing and level of Council on Postsecondary Education involvement in reviewing potential funding allocations from the ONE. The item now recommends that upon receipt of an application for funding from a postsecondary institution, the Office for the New Economy transmit a copy of that application to the Council on Postsecondary Education (CPE) to allow for CPE review and comment prior to action by the Kentucky Economic Development Finance Authority. Ms. Ingram noted that the wording of this revision had been reviewed by Mr. Hintze and Mr. Jackson, both of whom had been involved in the discussion at the last meeting.

Ms. Ingram said the second part of the recommendation addresses the need for the ONE to formalize its expectations for when a project will be self-supporting. It recommends that the Office for the New Economy incorporate into the agreement signed by funding recipients a clear statement of the timeframe in which it is expected that the project will generate sufficient indirect costs from federal grants and/or funding from private funds, royalties, or license fees to underwrite maintenance and operations costs.

Mr. Hintze's motion to accept the revised recommendation was seconded by Mr. Jackson, and approved without objection.

Ms. Ingram said the new policy recommendation addressed replenishing the Budget Reserve Trust Fund. She discussed the history and status of the BRTF as presented in the background section of the agenda item, then said the recommendation for consideration by the Board is that the Governor and General Assembly place a high priority on replenishing the Budget Reserve Trust Fund as quickly as possible to a level that represents 3 to 5 percent of General Fund revenues. Mr. Hintze's motion to accept the recommendation was seconded by Mr. Jackson, and approved without objection.

Representative Clark said the focus of the remainder of the meeting would be on the project recommendations to be included in the 2004-2010 statewide plan. He said after Ms. Ingram presented the draft recommendations there would be an opportunity for discussion and for the Board to provide further direction to the staff on how to proceed.

Ms. Ingram said three potential recommendations would be presented – projects to be financed from state funds, projects to reduce state leasing of space and facilitate consolidation of agencies, and projects to be financed from other than state funds.

Regarding projects to be financed from state funds, Ms. Ingram noted that information in the background section of the agenda item summarized the needs reported by the Executive Branch agencies and by the Judicial Branch in their 2004-2010 capital plans. It also noted that in the 2002-04 budget capital spending had been shifted away from state facilities and infrastructure, to local projects (e.g., schools, water and sewer infrastructure) and economic development programs. Ms. Ingram said the background went on to state that the Board is concerned that should the shift away from capital funding for state services and programs continue, the state's infrastructure and its ability to deliver services will be negatively affected. Further, the Board believes that good stewardship of assets acquired with revenues from the taxpayers requires that those assets be adequately maintained so as to provide a safe and health environment, and to minimize operating expenses.

The recommendation for consideration by the Board was that in the appropriation of state funds, the capital budgets recommended by the branch heads and enacted by the General Assembly should reflect a balanced approach to the needs that have been identified and should place a high priority on facilities, equipment, and technology to facilitate the provision of state services and programs. For 2004-06, the focus should be on those needs that have been identified to protect the state's current investment in capital assets or to replace those for which repair or renovation would not be a cost efficient or practical approach.

The general recommendation was followed by specific project recommendations grouped into seven categories. Ms. Ingram said the categories were listed in priority order, but the individual projects in those categories would not be in priority order.

First were maintenance or minor projects costing less than \$400,000 each. The recommendation was that funding for each agency maintenance pool should be at least equal to the level provided in the 2000-02 budget (approximately \$30 million), and that funding of \$15 million should be provided for a Capital Renewal and Maintenance Pool for the postsecondary institutions. The pool would be administered by the CPE, with a \$1 for \$1 matching requirement of institutional funds to access the state funds.

The next category was the statutory capital funding pools and programs. The recommendation was that funding to replenish the Capital Construction and Equipment Purchase Contingency Account and the Emergency Repair, Maintenance and Replacement Account should be provided to reach a level equal to \$10 million each at the beginning of FY 2004/05. Additionally, funding for the ongoing State-Owned Dam Repair Program should be provided consistent with the requirements of KRS 151.292 to

address needs documented for 2004-06 by the Natural Resources and Environmental Protection Cabinet.

The third category was major maintenance or capital renewal projects costing \$400,000 or more. The recommendation was that funding be provided to implement the long-range plan for housing state agencies in the Frankfort area to reduce lease space, as developed by the Finance and Administration Cabinet. The two specific projects to be recommended were renovation of the State Office Building, and design funding for the Capital Plaza Tower Renovation. Also in this category was a recommendation that funding of at least \$250 million be provided for other capital renewal and major maintenance projects at state agencies and postsecondary institutions. At this point in the recommendation, a list of projects developed by the Board would be inserted.

The fourth category of projects was information technology, with the recommendation being that funding of approximately \$100 million should be provided for information technology projects at the state agencies and postsecondary institutions. Another list would be inserted here. The information technology portion of the draft further stated that priority should be given to providing state funding for those projects deemed necessary to maintain the applications and infrastructure to support the critical functions of state government. It also stated that priority should also be placed on examining alternatives for financing technology needs including but not limited to approaches to making the most efficient and effective use of state funds, as well as options for financing projects from other than state funds.

The fifth category in the draft recommendation was court projects. It stated that authorization should be provided for approximately \$100 million in projects to provide adequate and safe court space based on the needs analysis conducted by the Administrative Office of the Courts and prioritized in the Judicial Branch's capital plan.

The sixth category in the draft was recommended the completion of previously authorized golf course projects. Ms. Ingram said this was a group of projects with some unique characteristics that caused them not to fit into the other priorities.

The seventh and final priority was new construction and grant/loan programs. The recommendation was that to the extent amounts are available beyond that required to address the above-stated needs, amounts should be provided for new construction, and for the grant and loan programs that provide assistance to non-state entities. Another list of projects the Board considers as high priorities for new construction funding would be inserted here.

Ms. Ingram said the specific dollar amounts that were proposed for the various categories – major maintenance, information technology, and court projects – in each instance represented about one-third of the needs identified for that category of projects

in 2004-06. Regarding the lists of projects to be inserted in the recommendation, she explained that as in the past they would be based on lists submitted by individual Board members. However, unlike previous planning processes, separate lists would be developed for each category rather than compiling various types of projects into a single list.

Mr. Deckard asked when action would be taken on this recommendation and expressed concern about the priority ranking assigned to court projects. Senator Robinson said the Board would not be asked to vote on the recommendation until the next meeting. At this meeting, some direction needs to be given to staff relative to continuing with this approach or changing it.

Mr. Mitchell asked whether priorities should even be assigned to the categories. He noted that especially when there are limited resources, the budget process generally would tend to fund each category at a lower level rather than going down a list of priorities. He said he is particularly concerned about placing the grant and loan programs in the lowest category.

Senator Robinson said he thought it was important for the Board to express an opinion based on its expertise in this area, rather than just presenting all of the needs.

Mr. Hintze said he generally likes the direction that has been presented, including associating substantial sums of money with the various categories of need and priority. He said recommending a balanced approach addresses the concern he previously expressed relative to the current budget funding the grant and loan programs essentially to the exclusion of other needs. He noted that the first two categories address the low-cost, high-priority repair and maintenance needs. The next three categories (major maintenance/capital renewal, information technology, and courthouse projects) are different types of projects, but all are of a similar nature and are consistent with the priorities the Board has set in the past. Finally, he said there is also a role for new construction and for the grant and loan programs, and noted that it might be appropriate to separate those two categories. He said it is important for the recommendation to make clear that the product of the Board's efforts is an endorsement of taking care of the state's existing investment.

Mr. Jackson said he thinks having various categories is a good approach. He said it is similar to the approach used by postsecondary education in making its project recommendations. He noted that postsecondary education has always operated with the understanding that it is not necessary to exhaust the higher priority before reaching into the next lower priority to fund a project. Senator Robinson said it would be good to include a similar statement of intent in the Board's recommendation.

Judge Wehr suggested that the recommendation be revised to group the categories as described by Mr. Hintze – particularly to group the three categories of major maintenance/capital renewal, information technology, and court projects. He suggested that specific priorities not be assigned to the categories within each grouping. Mr. Hintze said he would like to retain the individual project listings within the categories so that needs in each are clearly identified.

In response to Mr. Mitchell's question as to how the figures presented in the recommendation compare to the current capital budget, Mr. Hintze said there really is no comparison because the current budget did next to nothing apart from local grant programs. He noted the commonality between the major maintenance, information technology, and court projects, which are being proposed as subgroups within a single priority, is that there was essentially no funding for any of them in the current budget, while there was significant funding for the grants and loan programs for local water, sewer, and schools. He said the figures listed in the recommendation are a fair approximation of what would be provided in a normal budget. They may be a little low, which may be appropriate given the current fiscal climate.

Staff was asked to revise this recommendation for the next meeting based on the members' comments.

Ms. Ingram then proceeded to review the recommendation on projects to reduce state leasing of space and to facilitate consolidation of agencies. She noted that the background for the recommendation repeated the history of the Board's support for the construction of new state-owned space and reviewed the case that had been made in that regard previously - the need to reduce the amount of leased space, the need to consolidate agencies, and the financial benefits.

Ms. Ingram said the recommendation called for the authorization of two specific projects – the new federally-funded building proposed by the Workforce Development Cabinet to house the Department for Employment Services (DES), and the new state office complex proposed by the Finance and Administration Cabinet. With regard to the DES project, the recommendation also stated that efforts should be undertaken to determine if federal requirements would allow the construction of a facility larger than needed by DES, such that other state agencies could also be housed in the additional space through a lease arrangement. With regard to the Finance Cabinet proposal, the draft stated that to the extent state funds are not available for this project, the Board recommends that alternative financing approaches should be sought.

Mr. Mitchell's motion to accept the recommendation for projects to reduce state leasing of space and to facilitate consolidation of agencies was seconded by Mr. Hintze, and approved without objection.

Ms. Ingram next presented the final recommendation which addressed projects that would be financed 100 percent from other than state funds. She noted that rather than naming specific projects, the draft listed some items decision-makers should consider in authorizing such projects. It stated that in authorizing projects to be financed 100 percent from other than state funds and for which the other funds may be used for discretionary purposes, a high priority should be assigned to projects to address life/safety and deferred maintenance needs for which state funds were not provided. The recommendation then stated that in authorizing any projects to be financed 100 percent from other than state funds, the following factors should also be reviewed thoroughly: 1) Will the project require the expenditure of significant additional state funds for its operations and maintenance? 2) Will the project commit the state to fund significant costs to complete the project after the available other funds have been expended? 3) Are there any programs or operations also financed by the proposed fund source that would be jeopardized by the use of the funds for a capital project?

Mr. Hintze noted that while restricted, federal, and “other” funds are described as not being state funds for purposes of the Board’s recommendation, those fund sources are subject to appropriation and considered to be state funds in the biennial budget process.

Mr. Hintze’s motion to accept the recommendation was seconded by Mr. Jackson and approved without objection.

There being no further business to come before the Board, Mr. Karibo’s motion to adjourn was approved and the meeting was adjourned at 10:55 a.m.